Frequently Asked Questions on Tax Credit Bonds and Specified Tax Credit Bonds

2008 and 2009 tax legislation created several new types of tax-exempt bonds and tax-credit bonds under the Internal Revenue Code. Below are the answers to the most frequently asked questions regarding these new types of bonds. This set of Questions and Answers is offered to assist issuers with questions regarding qualified tax credit bonds but is not formal guidance. The Questions and Answers will be updated periodically and may be changed by subsequent IRS or Treasury guidance or Congressional section.

Tax Credit Bonds under IRC section 54A—Schools and Energy

Q-1. What are the new types of tax credit bonds under IRC section 54A?

A-1. There are four new tax credit bonds under IRC section 54A: Two are school bonds: Qualified Zone Academy Bonds ("QZABs") and Qualified School Construction Bonds ("QSCBs"). Two are energy bonds: New Clean Renewable Energy Bonds ("New CREBs") and Qualified Energy Conservation Bonds ("QECBs").

Q-2. For what purposes can tax credit bonds be issued?

A-2. Each of the tax credit bonds may be issued for different qualified purposes. In addition to complying with IRC section 54A, issuers of tax credit bonds must also comply with the IRC section that relates to each bond: for QZABS, section 54E; for QSCBs, section 54F; for New CREBs, section 54C; and, for QECBs, section 54D.

Q-3. What is the Federal subsidy for tax-credit bonds?

A-3. Holders of QZABs and QSCB receive a tax credit equal to 100% of the credit rate on the bonds. Holders of New CREBs and QECBs receive a tax credit equal to 70% of the credit rate on the bonds. The credit rate that applies to all four types of tax credit bonds under IRC section 54A is set at a rate the Secretary of the Treasury estimates will allow the issuer to sell the tax credit bonds at par, without interest or discount. That tax credit rate is published by the Bureau of Public Debt at: www.treasurydirect.gov. The issuer applies the credit rate in effect on the first day there is a binding, written contract to sell the bonds, generally the date the bond purchase agreement is signed. This Federal subsidy reduces borrowing costs to the issuer. (For more information on how the Secretary sets the tax credit rate, see Notice 2009-15.)

Q-4. How does the investor benefit from the tax credit?

A-4. The investor receives a tax credit, for QZABs and QSCBs equal to 100 % of the credit rate on the bonds, and for New CREBs and QECBs equal to 70% of the credit rate on the bonds. The amount of the tax credit is includable in the investor's gross income. The tax credit is generally allowed against both regular and alternative minimum tax. If the credit allowable exceeds the investor's limitation for that taxable year, the unused credit may be carried forward until used. There are no restrictions on the type of investor who can purchase tax credit bonds.

Q-5. Is there a maximum maturity for tax credit bonds?

A-5. Yes. The maximum term for these tax credit bonds is the term that the Secretary estimates will result in the present value of the obligation to repay the bond principal being equal to 50 percent of the face amount of the bond. This present value is determined using a discount rate equal to the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month. Currently, the maximum maturity is approximately 15 to 17 years. The maximum maturity is published by the Bureau of Public Debt at: www.treasurydirect.gov. The issuer applies the maximum maturity in effect on the first day there is a binding written contract for the sale of the bonds, generally when the bond purchase agreement is signed.

Q-6. Previous tax credit bonds have a requirement that 95% of proceeds be used for a qualified purpose; does that rule apply to the new tax credit bonds?

A-6. No, the rules under IRC section 54A are very strict. The issuer must spend 100% of "available project proceeds" for a qualified purpose for the type of tax credit bond being issued. Available project proceeds are the sales proceeds the issuer receives from the bonds minus proceeds spent on costs of issuance (up to 2%), plus proceeds from investment earnings. Thus, investment earnings on tax credit bonds must also be spent for the qualified purpose.

Q-7. May proceeds of the tax credit bonds be used to fund a reserve?

A-7. No, the issuer must spend 100% of available project proceeds on a qualified purpose. Funding a reserve is not a qualified purpose. However, the issuer may fund a reserve from other sources.

Q-8. Will arbitrage rules apply to a reserve funded from sources other than bond proceeds?

A-8. Yes, special arbitrage rules apply. The reserve may be funded no more rapidly than in equal annual installments; in a manner reasonably expected to result in an amount not greater than necessary to repay the bonds; and the yield on such fund is restricted to the “permitted sinking fund rate.” The permitted sinking fund rate” is set by the Secretary and is published by the Bureau of Public Debt at: www.treasurydirect.gov.

Q-9. Do expenditure periods apply to the proceeds of tax credit bonds?

A-9. Yes, issuers of tax credit bonds are required to spend 100% of available project proceeds within three years for one or more qualified purposes. If the issuer does not meet this expenditure requirement, the issue must redeem all of the nonqualified bonds within 90 days of the end of the 3-year period. (Extensions may be requested by the issuer in instances where failure is due to reasonable cause.)

Q-10. Are tax credit bonds subject to volume cap?

A-10. Yes, tax credit bonds are subject to separate volume caps for each category of tax credit bond. Tax credit bonds are not subject to section 146.

Q-11. How are tax credit bonds reported?

A-11. For 2009, tax credit bonds are reported on Form 8038.

Q-12. How does an issuer “designate” the type of tax credit bond issued?

A-12. Prior to issuing tax credit bonds, the issuer must indicate in its books and records its designation of the bonds as QZABs, QSCBs, New CREBs or QECBs.

Q-13. What is the conflict certification required for tax credit bonds?

A-13. An issuer of tax credit bonds must certify that it has met the requirements of State and local law governing conflicts of interest with respect to the bond issue.

Q-14. Do Davis-Bacon labor standards apply to construction projects financed by all tax credit bonds?

A-14. Yes, Davis-Bacon labor standards apply to all projects financed by the new tax credit bonds. For more information on these standards, go to www.dol.gov/whd/recovery/index.htm.

Qualified Zone Academy Bonds (“QZABs”) IRC section 54E

Q-15. For what purposes can QZABs be issued?

A-15. QZABS may be issued to rehabilitate or repair the public school facility in which the academy is established; to provide equipment for use at such academy; to develop course materials for education to be provided at such academy; and, to train teachers and other school personnel in such academy. QZABS may not be used for new construction.

Q-16. Who can issue QZABs?

A-16. Qualified Zone Academy Bonds may be issued by a State or local government within the jurisdiction of which a qualified zone academy is located.

Q-17. What is a qualified zone academy?

A-17. A qualified zone academy is any public school or program established and run by an eligible local education agency to educate and train students below the post secondary level if(1) the school or program is designed together with business to enhance the curriculum, increase graduation and employment and prepare students for the workforce; (2) the students will be subject to the same academy standards and assessments as other students in the eligible local education agency;(3) the comprehensive education plan is approved by the eligible local education agency; and (4) such public school is located in an empowerment zone or enterprise community or there is a reasonable expectation that at least 35% of students will be eligible for free or reduced-cost lunches .

Q-18. What is the private business contribution required for QZABs?

A-18. QZABs require the issuer to certify that it has satisfied the “private business contribution.” To satisfy the private business contribution, the issuer must have received written commitments from private entities having a present value of not less than 10% of the proceeds of the bonds. A qualified contribution consists of: equipment for use in the qualified zone academy (including state-of-the-art technology and vocational equipment); technical assistance in developing curriculum or in training teachers in order to provide appropriate market driven technology in the classroom; services of employees as volunteer mentors; internships, field trips, or other educational opportunities outside the academy for students; or, any other property or service specified by the eligible local educational agency.

Q-19. How is QZAB volume cap allocated?

A-19. The QZAB volume cap is allocated by the Secretary to the states according to their population below the poverty level. The national allocation to States and territories of $400 million for 2008 and of $1.4 billion for 2009 is set forth in Notice 2009-30, and the allocation of $1.4 billion for 2010 is set forth in Notice 2010-22.

Q-20. Can unused volume cap allocation for QZABs be carried forward?

A-20. Yes, but only for two years, then any unused allocation expires.

Qualified School Construction Bonds ("QSCBs") IRC Section 54D

Q-21. For what purposes can QSCBs be issued?

A-21. QSCBs may be issued to construct, rehabilitate, or repair a public school facility. With the exception of BIA-funded schools, QSCB proceeds may be used to acquire land provided that the facility to be constructed with the same issue of QSCBs will be located on the land. Proceeds may also be used to acquire equipment provided that the equipment is to be used in the portion of the public school facility that is being constructed, rehabilitated or repaired with part of the proceeds.

Q-22. Who can issue QSCBs?

A-22. Qualified School Construction Bonds may be issued by a State or local government within the jurisdiction of which the public school facility is located. An Indian tribal government that receives an allocation from the Department of the Interior may issue QSCBs for a BIA-funded school. Bond proceeds must be spent for a facility located within the jurisdiction of the issuer.

Q-23. How is QSCB volume cap allocated?

A-23. Generally, the QSCB volume cap is allocated by the Department of the Treasury. The national volume cap allocation of $11 billion for 2009 to States and large local educational agencies is set forth in Notice 2009-35. The national allocation of $11 billion for 2010 is set forth in Notice 2010-17. Additionally a volume cap allocation to construct, rehabilitate and repair schools funded by the Bureau of Indian Affairs of $200,000,000 for calendar year 2009 and $200,000,000 for calendar year 2010 is allocated by the Secretary of the Interior to Indian Tribal governments.

Q-24. Can unused volume cap allocation for QSCBs be carried forward?

A-24. A State or Indian tribal government may carry forward its unused volume cap allocation to future years without limitation. A large local educational agency (LEA) may reallocate their unused calendar year volume cap to the State in which it is located. Section 301(b)(2) of the Hiring Incentives to Restore Employment Act of 2010 provided a technical correction under § 54F(e) of the Internal Revenue Code allowing large LEAs to carryforward their volume cap in a similar manner as States.

New Clean Renewable Energy Bonds ("New CREBs") IRC section 54C

Q-25. For what purposes can New CREBs be issued?

A-25. New CREBs may be issued for capital expenditures for a qualified renewable energy facility. Qualified renewable energy facilities are facilities that generate electricity from wind, closed-loop biomass; open-loop biomass; geothermal or solar; small irrigation, hydro electric; gas from biodegradation of municipal solid waste; marine and hydrokinetic renewable; and trash combustion facilities. Bond proceeds may not be used to acquire existing facilities.

Q-26. Who can own a qualified renewable energy facility financed by New CREBs?

A-26. A qualified renewable energy facility financed by New CREBs must be owned by governmental bodies, public power providers and cooperative electric companies.

Q-27. Who can issue New CREBs?

A-27. New CREBs may be issued by a public power provider, a cooperative electric company, a governmental body, a clean renewable energy bond lender or a not-for-profit electric utility which has received a loan or loan guarantee under the Rural Electrification Act.

Q-28. How is New CREB volume cap allocated?

A-28. The national volume cap allocation for New CREBs of $2.4 billion is allocated by the Department of Treasury. Requirements for New CREB volume cap allocations were published in Notice 2009-33. Based on the Notice 2010-33 criteria and applications received, the volume cap allocations were awarded to the successful applicants by letter in 2009.

Q-29. Can unused volume cap be carried forward?

A-29. An allocation of New CREB volume cap is valid for three years after the date of the letter issuing the allocation. The IRS plans to reallocate any unallocated, unused, or relinquished volume cap.

Qualified Energy Conservation Bonds ("QECBs") IRC section 54F

Q-30. For what purpose can QECBs be issued?

A-30. QECBs may be issued for capital expenditures incurred for reducing energy consumption in publicly owned buildings by at least 20%; implementing green community programs (including the use of loans, grants or other repayment mechanisms to implement such programs); rural development involving the production of electricity from renewable energy resources; or any qualified facility including facilities that generate electricity from wind, closed-loop biomass; open-loop biomass; geothermal or solar; small irrigation, hydro electric; gas from biodegradation of municipal solid waste; marine and hydrokinetic renewable; and trash combustion facilities without regard to any placed in service date. QECB purposes are very broad and also include expenditures for certain research facilities and grants, mass commuting facilities, demonstration projects and public education campaigns to promote energy efficiency.

Q-31. Who can issue QECBs?

A-31. QECBs may be issued by a State or local government, including Indian tribal governments. The eligible costs for qualified conservation purposes financed with the proceeds of an issue of QECBs must relate to qualified conservation purposes that are located within or attributable to both the jurisdiction of the issuer of the QECBs and the jurisdiction of the entity authorized to allocate volume cap to an issue of QECBs.

Q-32. How is QECB volume cap allocated?

A-32. The national volume cap allocation for QECBs is $3.2 billion. Notice 2009-29 allocates the national limitation to States and territories. States must further allocate a portion of their allocation to large local governments based on population. The eligible costs for qualified conservation purposes financed with the proceeds of an issue of QECBs must relate to qualified conservation purposes that are located within or attributable to both the jurisdiction of the issuer of the QECBs and the jurisdiction of the entity authorized to allocate volume cap to an issue of QECBs.

Q-33. Can unused QECB volume cap be carried forward?

A-33. Unused QECB volume cap may be carried forward indefinitely.

Q-34. Can QECBs be private activity bonds?

A-34 Yes. QECB volume cap must be allocated by State and large local governments so that no more than 30% of the allocation is used for private activity bonds. Bonds issued for providing loans, grants or other repayment mechanisms for capital expenditure to implement green community programs are exempted from this requirement. All proceeds for private activity QECBs must be spent on capital expenditures.